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TAGS: ECON EFIN PREL KU
SUBJECT: KUWAIT'S CENTRAL BANK ACTS DECISIVELY TO STEM
TURMOIL AT GULF BANK

Classified By: ADCM OLIVER JOHN FOR REASONS 1.4 (b, d)

¶1. (C) Summary: After weeks of relative insulation from the global financial crisis, the GCC banking sector took its first hit on October 26, compelling the Central Bank of Kuwait to shore up the country's second largest bank, Gulf Bank, in the wake of significant trading losses. Gulf Bank's woes, a result of an institutional client's default on bad euro-dollar derivatives contracts, led the Central Bank to inject funds into Gulf Bank and announce it would guarantee all deposits in Kuwaiti banks. Although many prominent businessmen insist Gulf Bank's troubles are the result of "viral panic," the Council of Ministers nonetheless signaled its intent to establish a task force to explore options for dealing with the crisis. End summary.

¶2. (C) On October 26, the Central Bank of Kuwait halted trading in shares of Gulf Bank, Kuwait's second largest commercial bank, and announced that it was injecting an unspecified amount of cash into the bank and appointing government monitors to oversee the bank's operations. The bailout came in the wake of large trading losses incurred as a result of a large institutional client's failure to pay back liabilities arising from bad euro-dollar derivatives contracts. While Gulf Bank's precise role in these currency trades is unknown, media reports and Post's contacts at Gulf Bank confirm the client's default rendered Gulf Bank liable for the trading losses. On October 28, press reports announced the resignation of the bank's Chairman and Managing Director, Bassam Yusuf Ahmed Al-Ghanim and one other board member, Abdulkareem Al-Saeed. Bassam Al-Ghanim has been replaced by his brother, Qutaiba Al-Ghanim, the Chairman of the very large holding company, Al-Ghanim industries. (Note: It is an open secret that the Al-Ghanim brothers are not on the best of terms and have been in protracted negotiations to split up the family's valuable holdings, above all Al-Ghanim Industries and Gulf Bank. This had added another element of drama to the bank's woes. End note).

"WE'VE TAKEN A HIT"

¶3. (C) According to a contact in Gulf Bank's upper management, five large institutional clients incurred heavy losses relating to bad euro-dollar derivatives contracts. Four of these clients were able to satisfy their resultant liabilities. One of these clients ("a large Kuwaiti institutional investor," according to the Gulf Bank contact) defaulted on its liabilities arising from these trades, resulting in Gulf Bank itself incurring a significant loss. Estimates of the bank's liability range from $150 million to $925 million. Post's contact said that the Central Bank had (thus far) injected $400 million, and claimed that the bank's balance sheet was solid enough to pay back the liabilities itself, but that a decision was made by bank management to work with, and accept a cash infusion from, the Central Bank.

According to media reports, the Central Bank has retained British experts to evaluate the true losses incurred by Gulf Bank.

¶4. (C) The contact at Gulf Bank echoed the bank's public pronouncements that the bank remained on a sound financial footing, though he acknowledged that "we've taken a hit." He said that the bank's internal procedures and controls for currency trades might not have been fully adhered to in this case, compounding the bank's losses. (Note: Rumors abound in the Kuwaiti financial sector that the errant client might be an affiliate of one of the Al-Ghanim brothers' companies, and was able to benefit from preferential treatment by Gulf Bank's trading desk. End note).

STEMMING PANIC

¶5. (C) Local media reports and diwaniya rumors on October 26 and 27 indicated that Gulf Bank account holders were pulling out their deposits en masse, though, by all accounts, this appears to have been a gross exaggeration. For example, one diwaniya rumor, repeated to the Ambassador, suggested that a brother of Gulf Bank board member Mahdi Haider had withdrawn approximately $180 million immediately prior to the bailout, an example of both societal tittle-tattle and general market fears. Gulf Bank officials have repeatedly stated that there have been no widespread withdrawals by depositors. Trading in Gulf Bank's shares on the Kuwait Stock Exchange (KSE) has been suspended for the past three days, presumably to prevent a precipitous decline in the bank's share price and any

adverse affects on the wider banking sector. Concomitant with the bailout, the Central Bank said October 26 that it was preparing draft legislation for parliamentary consideration which would guarantee all deposits in Kuwaiti banks. Parliament formally approved this legislation on October 29.

¶6. (C) Following a Council of Ministers meeting on October 27, the GOK announced that it was forming a "specialized working team with executive powers to follow up and deal with the impact of the global financial crisis on Kuwait's economic and financial situations." According to sources in the financial sector, this task force is to be headed by the Governor of the Central Bank, Salem Abdulaziz Al-Sabah, and likely membership is to include the managing director of the Kuwait Investment Authority, Bader Al-Saad, representatives of the Ministries of Finance and Commerce, various Kuwaiti business owners and investors, and senior officials from the Union of Kuwaiti Banks and the Kuwaiti Chamber of Commerce. A prominent Kuwaiti businessman, however, complained that the process has already been politicized, noting that two prime candidates for the task force, Ibrahim Dabdoub, the Palestinian CEO of NBK bank, and Maha Al Ghunaim, were excluded; he because he is not Kuwaiti, and she because, as head of a large investment company, Global Investment House, might face conflicts of interest.

¶7. (C) Comment: The Gulf Bank bailout and suspension of trading of its shares on the KSE indicate that the Central Bank of Kuwait is more than prepared to act to shore up the local banking sector and to prevent panic and speculation from exacerbating the fallout from the global financial crisis. Gulf Bank itself will likely emerge from this crisis as an ongoing concern though with its reputation diminished. It is noteworthy that Parliament quickly passed legislation designed to guarantee deposits in Kuwaiti banks despite the highly contentious relations between the Parliament and the ruling family. Rapidly falling oil prices and the Gulf Bank bailout signal that Kuwait, and indeed the nations of the GCC, are far from immune from the effects of the global financial crisis, though Kuwait's historical public sector paternalism and swollen government coffers (resulting from

very large FY2008 oil revenues) will likely stave off any bankruptcies in the banking sector in the coming months. End comment.

JONES